SUMMARY of COOPERATIVE CASES

FARMER COOPERATIVE SERVICE
U. S. DEPARTMENT OF AGRICULTURE
WASHINGTON, D. C.

SUMMARY NO. 60

JUNE 1954

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The comments on cases reviewed herein represent the personal opinion of the author and not necessarily the official views of the Department of Agriculture.

NINTH CIRCUIT REVERSES TAX COURT IN CASWELL CASE

(Caswell v. C.I.R., 211 F. 2d 693)

In this case the Ninth Circuit Court of Appeals held that members of a cooperative marketing association had not received income as a result of distributions to them of interests in a "commercial reserve" which was subject to certain contingencies, the contingencies not having happened. This reversed the decision of the Tax Court in the case. (See Summary No. 53, p. 5.)

Caswell and he and his brother as a partnership were members of Turlock Cooperative Growers Association, through which they marketed their peaches. Under the marketing plan, the peaches were placed in a pool with peaches of like kind, grade, and classification produced by other members. When the peaches were sold and the pool was closed, the net proceeds, less an association charge, were distributed to the members on the basis of participation. The association charge, after payment of general organization and association expenses, was carried into a capital reserve and, in addition to the cash distributed, the members also received on the basis of participation in the selling pool, interest bearing certificates representing their interests in the capital reserve, which certificates they were free to sell, exchange, and assign.

With respect to this reserve the marketing contract provided:

> "From this Association charge, organization and other general Association expenses shall be deducted, and with the balance a commercial reserve shall be created. Whenever any commercial reserve is no longer needed for Association purposes, the Association shall distribute it among the Growers in the proportions to which they are entitled, determined on the basis of the amount retained from each Grower to create such a reserve."

The bylaw provision dealing with the reserve read:

> "The Association shall create and maintain a commercial reserve. This reserve shall be deducted from the Association charge and shall be used to purchase necessary equipment and property, to provide working capital and for other uses of the Association, including the purchase of stock of any corporation organized for the purpose among other

> things of manufacturing or selling the products of this Association, and with whom this Association shall contract for the manufacturing of such products. Certificates shall be issued bearing interest at the rate of six per cent per annum for and on account of the respective interest herein of the members of the Association."

The bylaws further provided for a distribution of the reserve upon the discontinuance of cooperative marketing by the association's members and sale of the association's assets by its directors.

The Tax Court had held (1) that the certificates issued to Caswell and the partnership in 1945 constituted income in that year to the extent of their fair market value; and (2) the fair market value of the certificates was equal to their face value. The Court of Appeals reversed this holding. It said:

> "The certificates issued to Wallace Caswell and the partnership in 1945 were mere evidences of their contingent rights in and to the commercial reserve fund mentioned above--rights which existed prior to 1945 under and by virtue of the Association's by-laws and the crop contracts mentioned above. The certificates did not give to Wallace Caswell or to the partnership or to the partners any new right or any greater right than they had before the certificates were issued. Under the by-laws and the contracts mentioned above, distributions were to be made to Wallace Caswell and the partnership from the Association's commercial reserve fund upon the happening of certain contingencies--termination of the Association's need for any commercial reserve, discontinuance of co-operative marketing by the Association's members and sale of the Association's assets by its directors. These contingencies never happened. Consequently no distribution was ever made to Wallace Caswell or to the partnership or to the partners or either of them. None of the certificates issued to Wallace Caswell or to the partnership in 1945 was ever sold, assigned, transferred or disposed of by Wallace Caswell or by the partnership or by the partners or either of them, nor did Wallace Caswell or the partnership or the partners or either of them ever receive anything for or on account of any of the certificates. Therefore none of the certificates issued to Wallace Caswell in 1945 constituted income of Wallace Caswell for 1945 to any extent whatever, nor did any of the certificates issued to the partnership in 1945 constitute income of the partners or either of them for 1945 to any extent whatever." (Emphasis added.)

TAXABILITY OF "RETAIN" CERTIFICATES

(Howey v. C.I.R., T.C. Memo. 1954-19, Doc. 39712)

In a memorandum opinion filed April 30, 1954, the Tax Court again held, on the basis of the particular facts before it, that the Internal Revenue Service was in error in attempting to tax certain "retain" or revolving fund certificates, issued by a tax-exempt cooperative to one of its patrons, at their face amount regardless of their fair market value.

Petitioner, Mary Grace Howey, is a citrus fruit grower, and, during 1947 and 1948, was a grower-member of the Plymouth Citrus Growers Association, a marketing cooperative organized under Florida law. During the years in question it held a letter of exemption under section 101 (12) of the Internal Revenue Code.

The Court found as facts, inter alia, the following:

> "Plymouth Citrus Growers Association is a nonprofit corporation without capital stock. During 1947 and 1948, it had approximately 250 members, who owned approximately 6,000 acres of land and contributed annually about two and one-half million boxes of citrus fruit. The association made available facilities for cultivating, harvesting, processing, and marketing the fruit of its members. Its activities included spraying, fertilizing, and cultivating the members' groves and picking, grading, sizing, processing, freezing, canning and marketing the fruit produced from such groves. It operated a cannery, a packing house and a fertilizer plant. It was a member of the Florida Citrus Exchange, an organization which markets the fruit of several cooperatives.
>
> "For marketing purposes Plymouth assigned its members' fruit to pools according to the type and variety of fruit, and the members shared in the proceeds of each pool in proportion to the quantity of fruit they furnished. Plymouth's management determined whether the fruit would be processed through the cannery or sold as fresh fruit. Plymouth remitted the proceeds to its members after first deducting the estimated cost of handling, processing and marketing.
>
> "Plymouth treated its fertilizer plant and grove caretaking service as a single activity. It purchased the necessary

ingredients and mixed the fertilizer according to the formulae that its production manager determined a particular grower needed. The grove caretaking service included purchasing trees from the nursery, planting such trees, irrigation of the groves, application of insecticides and fertilizer, cultivation and pruning of the trees, and other operations necessary to the proper planting and care of citrus groves. Each member was billed for the cost of fertilizer and insecticides used and of the grove caretaking service. The members paid such charges either in cash or through deductions taken from the proceeds of sale of their fruit.

"Petitioner purchased fertilizer through Plymouth and utilized its grove caretaking service to some extent. There was no written contract between petitioner and Plymouth in this regard. The only written contract between them was that which related to the harvesting, processing and marketing of fruit."

[At this point the findings quote extensively from the members' crop agreement, which petitioner had executed in 1944 and which was applicable to her marketings in 1947 and 1948; the Articles of Incorporation; and the Bylaws.]

"During the years 1947 and 1948, Plymouth Citrus Growers Association paid to petitioner the proceeds from the marketing of her fruit in cash less the actual cost of marketing her fruit and less an amount retained by it as a reserve for operating capital. Plymouth issued to her certain Certificates of Equity in Growers' Surplus, commonly referred to as 'retain' certificates for the amount it retained as a reserve for operating capital. There were separate reserves and certificates for the packing house, the cannery, and the fertilizer or grove caretaking activity. The certificates specified in dollars and cents the 'equitable interest' of the various members in the amount added to the reserve from operations of a particular year. There were no due dates on the certificates, they did not bear interest, and they were not transferable except in the discretion of Plymouth's directors.

"Some of Plymouth's 'retain' certificates have been reissued to new certificate holders, but it has been the policy of Plymouth's directors to approve such action only when the previous owner had died or when joint owners asked to have

their interests split. There have been no transfers on the books of Plymouth Citrus Growers Association of 'retain' certificates within the past 10 years as the result of sales.

"From time to time Plymouth's directors authorized the redemption in cash of 'retain' certificates applicable to particular crop years. Some certificates applicable to crop years preceding 1942 were redeemed during 1947 and 1948.

* * * * * *

"Plymouth Citrus Growers Association was not required by law, members crop agreement, its articles of incorporation or by its bylaws to issue Certificates of Equity in Growers' Surplus for amounts retained by it as a reserve.

"As of May 5, 1953, petitioner had not received payment from Plymouth of the amounts represented by the 'retain' certificates issued to her in 1947 and 1948. She has never demanded their payment nor requested permission to transfer them to others.

"As of May 5, 1953, Plymouth had not paid any 'retain' certificates issued since the 1942-1943 season nor had it set aside or earmarked any funds for the redemption of such certificates.

* * * * * *

"Plymouth did not redeem the 'retain certificates issued in 1947 and 1948 because Plymouth was restricted by its loan agreement with the Columbia Bank for Cooperatives from paying any 'retain' certificates without the bank's permission and there was no surplus cash available for their redemption.

"Two banks in Orlando, Florida will not accept Plymouth 'retain' certificates as collateral. Plymouth will not accept a 'retain' certificate from its members in payment for fertilizer or grove caretaking services.

"Petitioner resigned as a member of Plymouth Citrus Growers Association in 1948 and is no longer a member.

"On her income tax returns for the taxable years 1947 and 1948 petitioner disclosed as income the amounts remitted to her in cash by Plymouth from the proceeds of sale of her fruit. She also reported as income on her 1948 return certain amounts which she received in that year from Plymouth on account of the redemption of 'retain' certificates issued in earlier years. She did not disclose any amount as income in either 1947 or 1948 on account of the receipt of 'retain' certificates from Plymouth in those years.

"In the notice of deficiency respondent increased petitioner's taxable income for 1947 and 1948 by the amount of the 'retain' certificates issued to her by Plymouth in those years.

* * * * * *

"The six certificates issued to petitioner in 1947 and 1948 by Plymouth did not have at the time of their issuance a fair market value capable of being ascertained with reasonable certainty." (Underscoring added.)

Judge Opper's opinion, in the light of these facts, was as follows:

"Respondent once again attempts to tax 'retain' or revolving fund certificates, issued by a tax-exempt cooperative to one of its patrons, at their face amount regardless of their fair market value. But as we said in B. A. Carpenter, 20 T.C. 603, on appeal (C.A. 5):

> "'* * * The import of the decisions is that the member is not taxable unless the certificates have fair market value.'

"Nevertheless, the agency, reinvestment and constructive receipt theories are separately advanced. The facts demonstrate that Plymouth was no mere agent. In accordance with the power granted them by the Articles of Incorporation 1/ and the Florida statutes under which the cooperative was created 2/ the Board of Directors set up a reserve fund. The issuance of 'retain' certificates, redeemable and transferable only at the discretion of the directors, 3/ gave petitioner no real dominion or control over these funds. B. A. Carpenter, supra. See William A. Joplin, Jr., 17 T.C. 1526; P. Phillips, 17 T.C. 1027, on appeal (C.A. 5). But on the contrary

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"1/ Article 3 provides that 'any surplus * * * shall be used as the Board of Directors of this Association shall deem to the best interest of the Association.'

"2/ Secs. 618.07, 618.15 F.S. 1949.

"3/ The certificates say, for example: 'The Directors may apply any excess in Growers' Reserve to the retirement of these Certificates of Equity in the order issued, when, in their judgment, such excess exists.' (Emphasis added.)

the power of the directors to retain the funds whether or not they chose to issue the certificates, see P. Phillips, supra, cannot be doubted. This solitary attempted distinction from the Carpenter case is accordingly untenable. 4/

"As to the fair market value of the certificates, we think sufficient evidence has been introduced to overcome respondent's determination. They were non-interest bearing and not payable at any designated date. See Regulations 111, sec. 29.22 (a)-4. They were transferable only with the written consent of the directors, who were following a policy of sharply limiting such transfers. No certificates issued after 1943 have ever been redeemed, even in part, and at the end of 1948 more than one and one-half million dollars worth of these certificates, some extending back as far as 1933 and 1934, were outstanding. The agreement with the Bank for Cooperatives required that the certificates be subordinated to the bank's loan. These facts would all seem to indicate that any purchase of the certificates in the years in question would have been a highly speculative venture. We have accordingly found as a fact that the certificates had no ascertainable fair market value at the time of their issuance. See Helvering v. Tex-Penn Oil Co., 300 U.S. 481; B. A. Carpenter, supra; Harold H. Kuchman, 18 T.C. 154, acq. 1952-2 C.B.2; Edward J. Hudson, 11 T.C. 1042, 1050, aff'd. (C.A. 5) 183 F. 2d 180.

"In view of the disposition of the substantive issue we find it unnecessary to discuss the statute of limitations."

"4/ On the theory of the case advanced by respondent we need not consider the 'retain' certificates representing caretaking expense as in any respect different from those resulting from the marketing of the crop. Cf. P. Phillips, supra. Respondent states:

> "'* * * There is no claim or indication that Mrs. Howey advanced cash to Plymouth for such grove caretaking, hence it must be found that the actual expenditures were made from withheld marketing proceeds. * * * It is therefore submitted that this amount, like the rest of the retain certificates herein, represents additional income from marketing, hitherto unreported, which should now be added to her taxable income.'

It would seem clear from the recited facts that this was really a case where the association under its corporate papers had no mandatory obligation to pay over "any surplus" of amounts collected for expenses over actual expenses. Under these facts it is not surprising that the Court found no valid basis for holding that petitioner had received taxable income.

DISTRIBUTION OF NONPATRONAGE INCOME; DEDUCTIBILITY FOR TAX PURPOSES

(Informal Ruling of IRS)

At the request of a grain marketing cooperative, the Internal Revenue Service issued the following informal ruling on April 26, 1954:

"Dear Mr. _____:

"This is in reply to your letter dated _____, in which you request a ruling on behalf of [X Cooperative], with respect to the distribution as patronage dividends of net savings which the association will have for the fiscal year ended March 31, 1954 as the result of handling and storing grain of the Commodity Credit Corporation during such year.

"The [X Cooperative] is a cooperative marketing association exempt under the provisions of section 101(12)(A) of the Internal Revenue Code. It is engaged primarily in the business of storing and marketing grain for its members and patrons. Because of severe drought conditions in the territory served by the association there was during the current year an unprecedented low production of grain and a resultant unprecedented small amount of storage by members and patrons of grain in the association's storage facilities. During this year there was an abnormally high storage in the facilities of the association by Commodity Credit Corporation as a result of the heavy surplus of grain in other vicinities. Commodity Credit Corporation grain was moved in to utilize storage in the drought area in which the association operates. You have submitted comparative figures for fiscal years 1949 through 1954. These figures show that the number of patrons and the amount of bushels stored by patrons in the current year is abnormally low as compared with prior years.

"The association proposes to allocate and distribute to its patrons who have done business with it in the current year the net savings resulting from this business but as to the income resulting from handling and storing the grain of Commodity Credit Corporation during this year it is proposed to allocate and distribute such income on a patronage basis to its patrons who have done business with it during the fiscal years 1949, 1950, 1951, 1952, 1953 and 1954.

"Section 39.101(12)-1(c) of Regulations 118 provides that business done with the United States or any of its agencies shall be disregarded in determining the right to exemption under section 101(12) of the Internal Revenue Code.

"Section 39.101(12)-3(d) of Regulations 118 provides that business done with the United States shall constitute income not derived from patronage. This section of the Regulations allows as a deduction from the gross income of an exempt cooperative association amounts allocated during the year to patrons with respect to its income not derived from patronage. However, the section requires, in order that the deduction for income not derived from patronage may be applicable, it is necessary that the amount sought to be deducted be allocated on a patronage basis in proportion insofar as is practicable, to the amount of business done by or for patrons during the period to which such income is attributable.

"Based on the particular facts as you have presented them it is held that the income resulting from the handling and storage of grain of the Commodity Credit Corporation during the year ended March 31, 1954, which is distributed on a patronage basis to patrons who have done business with the association during any or all of the fiscal years 1949, 1950, 1951, 1952, 1953 and 1954 will not affect the exempt status to which the association is otherwise entitled under section 101(12)(A) of the Code.

"It is further held that the income from the handling and storage of Commodity Credit Corporation grain if distributed on a patronage basis in the manner indicated in the foregoing paragraph may be deducted from gross income of the association for the year ended March 31, 1954 provided the distribution is made on or before the 15th day of the ninth month following the close of the year.

"In making these rulings we have considered the unusual conditions which have existed during the year in the area in which the association operates. We agree with your conclusion that to distribute all of the nonpatronage income to the comparatively few patrons of this year would be to discriminate in their favor against the patrons of prior years, for the nonpatronage income of the current year must be considered at least in some measure attributable to the expansion of storage facilities which took place as the result of business done with patrons of those prior years.

"The rulings are based on the unusual circumstances with which the association has had to contend during the period and should not be considered as providing a basis for similar treatment of nonpatronage income in future years when the situation may be somewhat different.

Very truly yours,

(s) H. T. Swartz
Director, Tax Rulings Division"

SCOPE OF CAPPER-VOLSTEAD ACT DISCUSSED

(Cape Cod Food Products, Inc., v. National Cranberry Ass'n et al., 119 F. Supp. 900)

A cooperative which is formed under the Capper-Volstead Act violates neither the Sherman Act nor any other antitrust act in trying to acquire, or acquiring, even 100 percent of the market, if the cooperative does so exclusively through marketing agreements approved under the Capper-Volstead Act, and through those steps which involve cooperative purchasing and cooperative selling. This is the substance of one of U. S. District Judge Wyzanski's charges to the jury in the case cited above.

This action was brought by a food products company against four individuals and three corporations, including the cooperative National Cranberry Association, for damages alleged to have been sustained by reason of a conspiracy on the part of the defendants to violate the antitrust laws. The case is not fully reported. Only the judge's charge to the jury is given, plus a notation that the jury returned a verdict for plaintiff of $175,000 single damages and no appeal was prosecuted. It is understood that not all the defendants were found to be parties to the alleged conspiracy and National Cranberry Association was among the exonerated defendants. Apparently, the alleged conspiracy was that the defendants used their power to lend money and their power to foreclose loans in a way, and with the intent and purpose, of forcing the elimination of plaintiff as a competitor.

The following excerpts from the judge's charge should be of interest to farmers' marketing cooperatives organized in keeping with the Capper-Volstead Act:

> "To monopolize means to take steps toward acquiring a dominant position in the market, and to take such steps when you are not encouraged by the law. There is nothing unlawful under the Sherman Act or any other antitrust act in trying to get even 100 per cent of the market through skill, efficiency, superiority of product, or like entirely laudable steps. It is not unlawful under the anti-trust acts for a Capper-Volstead cooperative, such as the National Cranberry Association admittedly is, to try to acquire even 100 per cent of the market if it does it exclusively through marketing agreements approved under the Capper-Volstead Act, 7 U.S.C.A. §§ 291, 292.

* * * * * *

"Probably it would be appropriate for me now to say something about percentage figures, merely to get that question in its proper perspective. You will remember that I have said to you that even a showing in this case that the defendants held 100 per cent of the market would not by itself show a violation of the statute, because the defendants might have 100 per cent of the market as a result solely of skill, superior products, or following those practices which the Capper-Volstead Act, authorizes. And therefore, you are to draw no conclusive presumption from the fact that any particular percentage of the business has been achieved by any one or more of the defendants.

"On the other hand, this does not mean that percentage figures are entirely irrelevant. What you are trying to consider is what was the strength of the defendants in a particular market, and how did they achieve that strength? An increasing percentage and a very high percentage of the market may invite much more careful scrutiny than a small percentage. You are at least put on notice to look and ask what was the purpose and what were the means by which a particular percentage was reached."

At a later point the judge said:

"You will recall that when I talked about the Capper-Volstead Act, I referred to a cooperative which had a right under the law to unite for the purpose of purchasing cranberries and unite for the purpose of selling cranberries. There is nothing in the Capper-Volstead Act which gives a special privilege, exemption, immunity or the like, to the practice of processing cranberries. The statute is limited to buying and selling raw cranberries and other kinds of agricultural and like products."

He subsequently modified this statement, after discussion with defense counsel, by the following comment:

"I am reminded the Capper-Volstead Act does cover processing and I did erroneously state that it did not. This does not mean, either as a matter of statutory law or as a matter of a charge to you, that if the defendant association, the National Cranberry Association, were in any conspiracy with respect to credit or foreclosure or like means to eliminate a competitor, the Capper-Volstead Act gives an immunity. The immunity granted with respect to the phrase 'processing' has to do with manufacturing or like activities."

INITIAL DECISION VACATED IN FLORIDA CITRUS MUTUAL CASE

(In the matter of Florida Citrus Mutual, FTC Doc. No. 6074)

On May 10, 1954, the Federal Trade Commission issued an order sustaining the appeal of counsel in support of the complaint, reversing the initial decision (See Summary No. 57, p. 11) of the hearing examiner, and remanding the case to the hearing examiner. The decision was reversed on the procedural ground that the statutory issue of public interest is a matter of administrative discretion and is not properly within the adjudicatory processes under the hearing examiner. Chairman Howrey, although agreeing that the case should be remanded to the hearing examiner, strongly dissented from the reason assigned by the majority. He thought the case should be remanded because "the record does not establish that all the questioned practices have been abandoned and there is no clearcut declaration by respondent against resumption."

Particular matters mentioned on which further proof should be taken were "the operation of the voluntary allotment program," the continued existence of a large number of handler contracts which "gives Mutual the power to do wrong," and whether the improper practices had been stopped and there is no reasonable likelihood of resumption.

COOPERATIVE BUSINESS NOT TAXABLE AS ONE CARRIED ON FOR "GAIN OR PROFIT"

(Philadelphia School Dis't v. Frankford Grocery Co., 376 Pa. 542, 103 A. 2d 738)

A corporation, chartered as an ordinary business corporation but doing most of its business on a cooperative basis, was held by the Supreme Court of Pennsylvania not to be subject in connection with such business to a gross receipts tax levied on "every person engaged in business," where "business" was defined as an activity carried on for "gain or profit."

Excerpts from the opinion follow:

> "The history, structure and operation of the defendant are well summarized from the evidence adduced in the following portion of the opinion of the learned trial judge: '. . . The company originated in 1905 as the Frankford Retail Grocer Association, which name was changed to the present one in 1909. It was formed by a small group of fourteen or fifteen retailers to purchase goods in large quantities and eliminate wholesalers' profits because of chain store competition. The articles of incorporation stated that the purpose of the organization was to act as a purely cooperative enterprise of retail grocers. Every member stockholder in the corporation is obligated to buy sufficient capital stock to cover his average weekly purchases, and to deposit the stock with the company in escrow, and then to pay his bills weekly. This system eliminates credit losses. A member is not obligated to obtain all his supplies from the company. But ordinarily merchandise is distributed only to retail grocer members. Occasionally it is sold at cost to charities. In some instances a surplus of a commodity is sold on the open market in order to dispose of it. Each member receives only one weekly delivery. The company employs no salesmen and all ordersare received by mail or in person on written order blanks. Delivery of merchandise is controlled so that a truck covers a territory without duplication. In making deliveries the drivers deposit the goods on the pavements and do not carry them into the members' stores. Recently the company built a large warehouse to store inventories. A subsidiary corporation was formed for the purpose of holding title to this warehouse. All the stock is owned by the parent company. Capital was acquired by floating bonds which were practically all purchased by the retail grocer members. The goods which the company purchases for distribution are insured by it and title taken in its name. The

company provides advertising, accounting and promotion assistance to members. It operates schools to give instruction in the best methods of meat cutting and meat and produce merchandising. A construction department rebuilds stores for members, installs fixtures and display stands and equipment, and services refrigeration equipment. The company also purchases store equipment for members. It has established and promoted a "Unity" brand name which it owns and which represents a valuable good will. The membership of the company averages 2,050 members whose total sales volume is approximately one hundred million dollars. Officers and employees own about 321 shares of the total number of 12,393 shares of stock outstanding. As already pointed out, the retail grocer members who own the rest of the shares were required to invest in sufficient capital stock to cover average weekly withdrawals. Upon retirement from the organization the member must surrender his stock for its par value. The same applies to stock held by officers and employees. The withdrawal "price" of merchandise to retail grocer members is determined as near to cost as possible. Usually at the end of a fiscal year there is an excess of receipts over total costs. This fund is distributed to members in proportion to the withdrawals they have made, as a patronage dividend. A permissive dividend on shares of $5.00 each has also been customarily declared; this dividend also goes to employees who hold shares. The company has some surplus, part of which is in the form of securities of a market value of $304,006.25. This surplus was acquired prior to 1945, since in 1944 an amendment to the charter and by-laws limited the amount which could be added to costs in order to contribute to the fund available for the stock dividend which is paid primarily from the profit on sales and services to non-members. This increment to costs is confined to .003% of the total deposits by members. This limitation is expressly set forth in the application and contract executed by the retail grocer members, and existed in the tax year 1949.'

* * * * * *

"The plaintiff contended in the lower court, as it does here, that the word 'business' as defined in the Act should be given a broad meaning so as to include any commercial activity and not be limited to a business carried on for gain or profit; that the defendant is organized as a business corporation and not as a nonprofit or cooperative association; that its by-laws and contracts with its retail grocer members refer to its activities as 'business'; that its receipts exceed cost and hence

result in a profit. The defendant admits that it is engaged in business but not in business for profit in so far as its cooperative functioning is concerned. As to the latter, it asserts that the business it conducts is really the business of its constitutent retail grocer members who pay the general business tax; that it must be considered the alter ego of its members or their agent. The defendant's corporate purpose, as stated in its by-laws, is: 'The purpose for which this Company is organized and incorporated is to act as a purely cooperative enterprise of retail grocers in the purchasing and warehousing of food and merchandise for its retail-grocer shareholders and to distribute said food and merchandise to them on their respective orders.'

* * * * * *

"The matter thus reduces itself to the question whether the defendant in its cooperative functioning is carrying on a business for gain or profit, and therefore within the purview of the tax. We deem it unimportant that it is incorporated under the Business Corporation Law. We are not concerned with the form but with the substance of its structure and operation in its cooperative activities. That it pays the tax on some of its activities does not prevent immunity from tax on its nonprofit activities. . . .

* * * * * *

"We think there is a persuasive indication that the Legislature did not contemplate the inclusion of cooperatives in that double taxation would result. Each individual retail grocer member would not only pay, as he does, the tax on his gross receipts, but also on his intermediate purchasing methods. In the case of a chain store, the tax is paid only on receipts from retail sales and not on the purchase, storage and distribution of the merchandise to its retail outlets.

"While it is true that the defendant conducts its operations as a corporation, which is the tendency of most cooperative associations today, it possesses all of the attributes of a purchasing cooperative. In their present form and mode of operation, purchasing cooperatives are of comparatively recent origin and, like all cooperatives, they are somewhat of a hybrid, partaking both of the nature of a corporation and of a partnership. But basically a purchasing

cooperative acts as the joint agent of all its member principals in purchasing in bulk and distributing at cost the products sold by its members. That it also acts as such agent in supplying at cost equipment and services incidental to and in furtherance of the economic objectives of its principals, does not change its character. By means of this principle of unified action the merchants secure the advantages of quantity buying, eliminate wholesalers' profits and attain a position where they can compete on even terms with the giant grocery chains. Viewing the defendant as an enterprise separate and distinct from its members, it has what superficially resembles a profit, that is, an excess of receipts over cost of operation. Realistically, however, the apparent profit is due entirely to the fact that each cooperator has paid in more than enough to cover the cost of the products he obtains for himself. By reason of the contract between the organization and each cooperator, this money belongs to the latter. When a group of individuals enter into an agreement to pool their resources for a common purpose and state therein that their contributions to the extent not required for that purpose shall be repaid to them, it is hard to conceive how the contributions returned to them should be regarded as a gain or profit to the entity acting as their mutual agent. The activities of the agent are the activities of its principals with the result that it is the retail grocer members who are purchasing the merchandise, storing it, distributing and selling it at retail, and they are the parties who realize the profit from the sale to the ultimate consumer. They owe and pay the tax on their gross receipts. Surely reimbursements or advancements made by them as principals to their agent for merchandise purchased by the agent for them are not subject to the tax. Indeed this is recognized by the School District in the regulations covering taxability under the Act.

* * * * * *

"Conflicting views are expressed in the appellate courts of other States as to the tax status of cooperatives under the particular state statutes involved. Confining ourselves to the Pennsylvania statute here in question, we are of the opinion that the defendant in its cooperative functioning is not conducting an independent business separate and apart from its constituent members, and its receipts from them in payment for their withdrawal of merchandise purchased for their account, are not taxable."

NONMEMBER TENANTS AND SHARECROPPERS ENTITLED TO PATRONAGE REFUNDS

(Collie v. Coleman, 265 S.W. 2d 515)

This case, decided by the Supreme Court of Arkansas on February 22, 1954 (rehearing denied March 29, 1954), involved the question whether nonmember tenants and sharecroppers of a landlord member of a cooperative gin were entitled to a share of the patronage refunds declared and paid by the gin to the landlord. The court held that under the facts involved the tenants and sharecroppers were entitled to judgment against the landlord for the patronage refunds resulting from the ginning of their portion of the crop, except where the claims were barred by the statute of limitations.

The court said that the cooperative gin and the landlord had the burden of proving that when the nonmember tenants and sharecroppers entered into their rental contracts, they had waived their right to the refunds. The evidence was then reviewed, and the conclusion reached that it did not establish such a waiver. The court next looked to the cooperative's bylaws, which provided that members and nonmembers should be treated the same, and should participate in patronage refunds on the same basis. From this it concluded that the nonmember tenants and sharecroppers should share in the patronage refunds since they had not waived that right when they entered into their rental contracts.

In reaching this conclusion, the majority of the court relied on the case of Houck v. Birmingham, 217 Ark. 449, 230 S.W. 2d 952 (See Summary No. 47, p. 1). In this connection the court said (p. 517):

> "The Houck case involved the same kind of cooperative gin, the same question relative to refunds, and other similar pertinent facts, and it was there held that share cropper tenants were entitled to patronage payments. Three of the appellants here were share croppers, while the other appellants paid as rent one-fourth of the cotton raised. In the Houck opinion it was made clear that the latter class of renters were in a more favored position to claim refunds than were share croppers, so no distinction need be made between the two classes of renters in so far as it relates to this opinion.

"In reply to appellants' reliance on the Houck opinion, appellees advance two arguments. First, that said opinion leads to an affirmance here, and, second, that the two cases are distinguished because the Articles of Incorporation and the By-laws of the two Cooperatives involved are not the same. We shall now examine these two arguments in the order mentioned.

"First. Referring to the Houck opinion, appellees call attention to this language: 'The nature of the cropper's right in the crops, or the proceeds thereof, depends upon the intent of the parties as ascertained from their contract.' Based on this language the argument is made, that, before appellants can win they must show it was their intent, when the rental contracts were entered into, to receive refunds, and, that no such intent is shown by the evidence. It is true that the evidence discloses no such intent on the part of the renters. In fact, it is specifically stated by appellants that they had no such intent because they never thought of refunds until the opinion in the Houck case was delivered. We think, however, that the above-quoted language does not have the significance attached to it by appellees. The language was used in the Houck opinion in an effort to distinguish between the legal status of a share cropper who receives one-half of the crop from his landlord and the status of one who pays one-fourth of the crop to his landlord. There the court was dealing with share croppers, and an analysis of the whole opinion shows clearly that they were entitled to refunds because of the provisions in the Articles of Incorporation and the By-laws of the Cooperative Gin and not because the share croppers intended or contracted to receive refunds when the rental contracts were made with their landlord.

"Second. As indicated above, appellees make the argument that the opinion in the Houck case is not controlling here because the Articles of Incorporation and the By-laws in the Planters Cooperative, under consideration in that case, are not the same as the Articles of Incorporation and the By-laws in this case. Referring to the Houck case appellees state 'that case certainly is not in point with the case at bar. The By-laws of that cooperative were entirely different to the By-laws of the Little River Cooperative Gin, Inc.' At another time appellees, in an effort to show that non-members are not entitled to refunds here, quote Article III in the By-laws of Little River which deals with

qualifications for membership. Appellees' position in this connection is without merit. A careful comparison of the Little River Articles of Incorporation which appear in full in the record are exactly like the Articles of Incorporation considered in the Houck case, as is shown by a comparison of the records in both cases. The same thing is true of the By-laws of both cooperatives with the following non-essential exception. In this case the Little River By-laws are copied in full in the record. In the Houck case some of the Articles of the By-laws are omitted entirely, but the following Articles do appear in full: Article III on Membership; Article IV on Non-member Patrons; Article X on Audits and Determination of Savings. The last mentioned Articles are exactly like the corresponding Articles in the By-laws of Little River and they are the only Articles in the By-laws that have any bearing whatever on the issue considered here.

"In view of the above it is our conclusion that the opinion in the Houck case is controlling here, and it would serve no useful purpose to reiterate the reasons used and the conclusions reached in that case."

Two judges dissented on the ground that the evidence established that the tenants and sharecroppers had waived their rights to share in the refunds.

DRESSED POULTRY HELD AGRICULTURAL COMMODITY

(I.C.C. v. Allen E. Kroblin, Inc. ____ F. 2d ____)

The U.S. Court of Appeals, Eighth Circuit, affirmed a lower court decision on May 11, 1954, holding that New York dressed and eviscerated poultry is not a "manufactured product" but is an agricultural commodity within the meaning of 49 U.S.C. 303(b)(6) of the Interstate Commerce Commission Act. (See Summary No. 57, p. 13.)

The court referred to the exhaustive analysis of the question by the lower court (113 F. Supp. 599) and stated that it agreed fully with the views expressed. It supplemented this statement as follows:

> "If we were to undertake to add a word, it would be simply to emphasize the inescapable fact that, when Congress, in its enactment of § 303(b), chose to change the language of the exemption here involved, as it had been originally drafted and recommended by Charles F. Eastman, then Federal Coordinator of Transportation and long a member of the Interstate Commerce Commission, from one for motor vehicles used 'exclusively in carrying * * * unprocessed agricultural products', to one for motor vehicles used 'in carrying * * * agricultural commodities (not including manufactured products thereof), if such motor vehicles are not used in carrying any other property, or passengers, for compensation,' the result necessarily was to put processed agricultural commodities, not rising to the state of a manufactured product, in the same class with unprocessed agricultural commodities, for purposes of the exemption.
>
> "Also, the statements made from the legislative floor, on which the amending action was predicated, that it was desired to make certain that pasteurized milk and ginned cotton would be left outside the certificating requirements of the Act, necessarily implied a recognition that, in the realities of agricultural marketing and distribution, certain processing incidents were inherent in or commercially attendant upon the existence of an outlet for the farmer, at a local or relatively local level, for various of his commodities, as a step in the channelizing of them into their natural-commodity market, and that the degree of freedom and flexibility allowed in the further transportation of such processed

commodities, not reaching a manufactured state, was as much and as directly linked with the ability of the farmer to sell these commodities conveniently or to receive an advantageous price for them as in the case of unprocessed agricultural commodities. In other words, Congress obviously intended that, as a matter of relationship to the agricultural economy, the accomplishing of a distribution of processed agricultural commodities, not constituting manufactured products, should, within the necessities or practicalities of a marketing of them as such, be made to have no more transportational impact upon the farmer than the marketing of his unprocessed commodities.

"And within the realities of marketing and distributing poultry, the dressing thereof at the local market level would seem to be no more of a step in the disposing of it as poultry than would the pasteurizing of milk or the ginning of cotton in disposing of them as milk and cotton. Certainly, no less could hardly be done to make practicable the hauling of poultry as such, for natural food purposes, than a removing of the head and feathers thereof. Nor is it claimed here that there is any difference between New York dressed poultry and eviscerated poultry in relation to the question of manufactured products. The position of the Commission in its naked effect - though not thus baldly phrased - is simply that, as a matter of giving motor-carrier regulation as full a scope as possible, a chicken should be regarded as being converted into a manufactured product whenever its head has been cut off. . . . Neither the language nor the spirit of the agricultural exemption warrants us in adopting any such artificial concept and curb in the realities of marketing agricultural commodities."

SERVICE CONTRACT BETWEEN CREAMERY AND CONSUMERS' CO-OP HELD VALID

(Eaton v. Brock, 268 P. 2d 58)

In this case it was held that a contract between a creamery and the Consumers' Cooperative Society of Palo Alto, California, whereby for a consideration of $1.20 per month per customer the cooperative undertook to collect and guarantee payment of all accounts of creamery's customers who were members of the cooperative and to solicit new customers, was supported by adequate consideration and did not violate the unfair practice provisions of the State Milk Control Act (Agricultural Code §§ 4280, 4361; Corporations Code §§ 12200 - 12956.

The following statement by the court, concerning the fact that patronage refunds do not constitute illegal rebates, may be of general interest:

> "Before leaving this phase of the case it perhaps should be noted that at the trial of the instant action defendant abandoned his affirmative defense that Co-op's distribution of a portion of its profits among its members constitutes an unlawful rebate (Agricultural Code, section 4361) to those of its members who are customers of Eaton. Defendant deferred to the decision in Certified Grocers of California v. State Bd. of Equalization, 100 Cal. App. 2d 289, 223 P. 2d 291. In that case the court held that the provisions of the Corporations Code which permit cooperative corporations to declare patronage dividends are paramount to the provisions of the Alcoholic Beverage Control Act which prohibit sales of liquor at less than posted prices and secret rebates. In view of these facts no more need be said of this defense."